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In The

Supreme Court of the United States

October Term, 1981

ASARCO INCORPORATED (formerly THE AMERICAN SMELTING AND REFINING COMPANY),

Appellant,

vs.

IDAHO STATE TAX COMMISSION,

Appellee.

APPEAL FROM THE SUPREME COURT OF IDAHO

BRIEF OF APPELLEE

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COUNTER-STATEMENT OF QUESTIONS PRESENTED

1. Are the provisions of the Uniform Division of Income for Tax Purposes Act (UDITPA), as adopted in Idaho and construed by the Idaho Supreme Court, requiring apportionment of income from intangibles acquired, managed and disposed of as a regular part of the taxpayer's unitary trade or business operations consistent with the Due Process Clause of the Fourteenth Amendment?

2. Are the provisions of UDITPA, as enacted in Idaho and construed by the Idaho Supreme Court, requiring apportionment of income received from intangibles acquired, managed and disposed of as a regular part of the taxpayer's unitary trade or business consistent with the Commerce Clause of Article I, Section 8 of the Constitution?

3. Was the Idaho Supreme Court's holding that under UDITPA no adjustment to apportionment factors is required consistent with the Due Process and Foreign Commerce Clauses?

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COUNTER-STATEMENT OF THE CASE[1]

ASARCO is a multinational corporation which mines copper, gold, silver, lead, zinc and other non-ferrous metals, smelts and refines these metals and sells secondary metals [Joint Appendix (hereinafter "J. A.") pp. 83a-84a].

Principally in Idaho it mines silver although it also mines lead and zinc, operates its northwest mining division administrative office and sells secondary metals. Ore from Idaho mining is shipped to its own smelters outside Idaho. During 1968, 1969 and 1970, ASARCO also conducted extensive exploration in Idaho. (Reporter's Transcript (Rptr's Tr.) pp. 8-12, 146-147, 15-17 and J. A. pp. 38a-40a).

ASARCO reported its Idaho taxable income in 1969 and 1970 on the basis that it conducted a unitary business both within and without Idaho. (J. A. pp. 105a-119a). It does not contend that its operations conducted partly in Idaho were not an integral part of its overall business; but its income tax returns excluded from apportionable income the gross amount of all income from intangibles (including interest, dividends, royalties and income from sale of stocks) and the gross income from the rental of housing to its employees (without deduction of related business expenses). (J. A. p. 109a, ln. 31h and p. 117a, ln. 31j).

Based upon an audit by the Multistate Tax Commission (MTC) on behalf of Idaho and five other states, the

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1 Much of the factual record is a lengthy stipulation of the parties (J. A. pp. 26a-119a). One exhibit to the stipulation is the narrative report of the auditor who performed the audit upon which these assessments were based. The parties stipulated that "the facts reflected in the MTC audit report are correct . . ." except as they related to adjustments to the sales factor—an issue not before this Court. (J. A. p. 26a ¶ 1). This report is at J. A. pp. 83a-103a.

Idaho State Tax Commission (Commission) combined with ASARCO six of its wholly owned domestic and foreign subsidiaries, thus taxing ASARCO in reference to the combined group. Additionally, the Commission reclassified as apportionable income all income from intangibles (other than that received from the combined subsidiaries). (J. A. pp. 59a, 67a, 75a). ASARCO unsuccessfully protested both adjustments to the Commission. [Juris. State. Appendix (J. S. App.) pp. 46a-62a]. It then appealed to the state district court which upheld the combination but overturned, on statutory grounds, the apportionment of income from intangibles. (J. S. App. 36a-37a). The Commission appealed the district court's conclusion that the intangible income could not be apportioned. ASARCO did not cross-appeal on the combination.

The Idaho Supreme Court, construing the statute (UDITPA), concluded that ASARCO had proven, by clear and convincing evidence, that some of these intangible assets were *not* acquired, managed or disposed of as a regular part of ASARCO's business. Thus substantial dividends from Lake Asbestos of Quebec, Ltd., and from ASARCO International, Hecla Mining Company, Kennecott Copper Company, Phelps-Dodge and United Park City Mines could not be apportioned by Idaho. (J. S. App. p. 23a). However, that court, still applying the statute, held that the other dividends, interest, gains, rents and royalties were earned from assets acquired, managed and disposed of in the regular course of ASARCO's unitary business, a part of which was conducted in Idaho. (J. S. App. p. 22a). Answering ASARCO's constitutional challenge, the Idaho court concluded:

> "any constitutional limitation upon a state's right to apportion the intangible income, including dividends, of a multistate corporation doing business within the

state are satisfied by the Idaho statutory requirement that the acquisition, management or disposition of the underlying asset must be an integral or necessary part of the taxpayer's unitary business, a part of which is conducted in this state." (J. S. App. p. 28a).

On appeal to this Court, the judgment of the Idaho Supreme Court was vacated and remanded "for further consideration in light of" *Mobil Oil Corp. v. Commissioner of Taxes of Vermont*, 445 U. S. 425 (1980) (J. S. App. 3a). Complying with the remand, the Idaho court received briefs and heard oral arguments from the parties and their amici. After analysis of both *Mobil, supra*, and *Exxon Corp. v. Wisconsin Dept. of Revenue*, 447 U. S. 207 (1980), the Idaho court reinstated its original opinion without change (J. S. App. pp. 1a-2a).

SUMMARY OF THE ARGUMENT

(1) ASARCO interprets this Court's decision in *Mobil Oil Corp. v. Commissioner of Taxes of Vermont*, 445 U. S. 425 (1980), too narrowly and inconsistently with other decisions of this Court. ASARCO contends that Idaho cannot apportion dividends, interest and capital gains from shareholdings in corporations in which it held substantial interest because, it alleges, there is no functional integration between ASARCO and those corporations. However, "functional integration" is not the proper due process test. The Due Process Clause requires that to apportion interstate income there must be (a) a minimal connection between the interstate activities and the taxing state and (b) a rational relationship between the income attributed to the state and the intrastate values of the activities taxed. *Mobil, supra.* A taxpayer attacking an apportionment result must show by clear and cogent evi-

dence that the tax does not meet these two due process requirements. *Butler Bros. v. McColgan*, 315 U. S. 501 (1942). ASARCO has not met this evidentiary standard in regard to either of these two due process requirements.

This Court has never held that intangibles or income from intangibles may not be apportioned if they are part of a unitary business partly conducted in the taxing state. Intangibles are part of a unitary business if they are acquired, managed or disposed of for purposes relating or contributing to the taxpayer's business. It is this integration—i. e., between the business use of the intangible asset (the shares of stock) and ASARCO's mining, smelting and refining business—which makes the income part of the unitary business. If the income is part of ASARCO's own unitary business, the minimal connection requirement is satisfied.

While in some cases (as in *Mobil*), the existence of functional integration may establish that the intangibles are held for a purpose related to the unitary business; for due process purposes, it is the unitary business purpose not the functional integration which is controlling. Because the Idaho court justifiably found that these intangibles were acquired, managed and disposed of as a necessary part of the taxpayer's regular unitary business, the minimal connection requirement of the Due Process Clause is met.

The Idaho court carefully reviewed the factual record relating to all of the corporations from whose stock ASARCO received income. In regard to some stock, the Idaho court found that ASARCO had met the evidentiary requirement of *Idaho Code* § 63-3027 (a) (1) and had clearly separated these intangibles from its unitary business. That court therefore rejected the Idaho Tax Commission's at-

tempt to apportion income earned from these intangibles. The Idaho court concluded that the intangibles generating income challenged by ASARCO were assets held by ASARCO for purposes relating to its unitary mining, smelting and refining business. Substantial evidence in the record supports the Idaho court's opinion. Therefore, this Court should accept the Idaho court's factual finding and affirm its conclusion that the income may be apportioned.

(2) Alternatively to its main argument, ASARCO suggests that if dividends are apportioned then both the Due Process and Foreign Commerce Clauses require that the factors (property, payroll and sales) in the apportionment formula be adjusted to include in the denominators of ASARCO's factors proportionate parts of the property, payroll and sales of the corporations from whose stock the income was earned.

(a) ASARCO's second due process argument suffers from the same fallacy that undermines its principal due process argument that the income is not apportionable. The income being apportioned is its own income, not that of the payor corporations. ASARCO is a separate and distinct taxpayer. The due process issue is whether the income was earned as part of ASARCO's own unitary business. If it was, then the decisions of this court support apportioning that income to those jurisdictions in which ASARCO conducted its unitary business activities. The three factors used by Idaho—and most states—accomplish that result by attributing income to where the taxpayer's property, payroll and sales are located. Because the income is part of ASARCO's own unitary income and because the formula, without adjustment, apportions that income to the places where that unitary business is

conducted, nothing in the Due Process Clause requires modification of the formula.

ASARCO's contention that the property, payroll and sales of the payor corporations must be recognized in the formula confuses the apportionment of unitary income with the use of a "combined report" of income. The Idaho statute provides—and the Idaho court in this case required[2]—that if two or more corporations are together engaged in a functionally integrated unitary business both their income and their apportionment factors are to be combined together and tax computed as if the combined group is a single taxpayer. Such a combination accounts for all the business activities of corporations engaged in a unitary business, thereby recognizing activities of functionally integrated subsidiaries. These are two different aspects of the unitary business principle. Combined reporting identifies a unitary business consisting of two or more corporations. Defining apportionable income determines what income was earned by that business as a regular part of its unitary business activities which may, therefore, be apportioned. ASARCO's position totally fails to recognize this critical distinction.

(b) ASARCO's Foreign Commerce Clause argument was firmly rejected by this Court in *Mobil*. Although ASARCO purports to present an issue different than that decided in *Mobil*—i. e., that this income is immune from all state taxation—the issue really is not different. ASARCO relies only upon *Japan Lines v. County of Los Angeles*, 441 U. S. 434 (1979), for support. But that case dealt with property taxation of instrumentalities of foreign commerce when an international treaty expressly pro-

2 The trial court upheld, and ASARCO did not appeal, the combination of ASARCO with six of its wholly owned subsidiaries with which the court found ASARCO was conducting a unitary business.

hibited such taxation. As the *Mobil* court recognized, *Japan Lines* is irrelevant when a state seeks to determine the amount of a domestic taxpayer's unitary income attributable to that state. Additionally, as the *Mobil* court recognized, concurrent state and federal taxation is "an established norm." Even if duplicative taxation exists—which it does not because the foreign taxes are creditable against ASARCO's federal income taxes—there is no reason to prohibit concurrent state and foreign taxation. Furthermore, ASARCO is an American corporation doing business in the United States. Attribution of part of its income to a state of the United States is a wholly domestic question—not one of international law or policy. Therefore, any treaties or federal tax policies relating to international taxation are irrelevant.

(3) The record in the courts below is deficient as to all of the foregoing propositions. To successfully attack a state's apportionment result, the taxpayer must show "by clear and cogent evidence" that the result reaches extraterritorial values. ASARCO only presented as evidence its own irrelevant internal separate accounting analysis. This Court has rejected separate accounting as an insufficient method for impeaching a state's apportionment result in every case in which it has been presented. See e.g. *Exxon Corporation v. Wisconsin Dept. of Revenue*, 447 U.S. 207 (1980).

This same lack of an adequate factual showing of distortion also applies to the first part of ASARCO's alternative argument that the Due Process Clause requires factor adjustments. As to its argument that factor adjustments are required by the Foreign Commerce Clause to prevent duplicative foreign taxation, the record is utterly devoid of any attempt to show that foreign taxes were paid, to which countries they were paid, by

which corporations they were paid, the amounts paid by each corporation to each country, or the legal incident of the foreign tax. Therefore, in order to address the effect, if any, such foreign taxation may have on the state's apportionment result, this Court must indulge in assumptions and speculations not justified by the record.

THE ARGUMENT

I.

Idaho only seeks to apportion income earned by ASARCO in the regular course of its integrated unitary business, a part of which is conducted in Idaho, in the manner permitted by the Due Process Clause.

The Due Process Clause allows income earned in interstate commerce to be apportioned if there is (a) a minimal connection between the interstate activities and the taxing state and (b) a rational relationship between the income attributed to the state and the intrastate values of the activities taxed. *Moorman Mfg. Company v. Bair,* 437 U.S. 267, 272-273 (1978); *Mobil Oil Corp v. Commissioner of Taxes of Vermont,* 445 U.S. 425 (1980). A taxpayer who attacks a state's apportionment result must show by clear and cogent evidence that the state's tax does not meet these two due process requirements. *Butler Bros. v. McColgan,* 315 U. S. 501 (1942). In part I of this brief, we shall show: (a) The due process requirements are met when the income to be apportioned is earned from intangibles which are acquired, managed and disposed of as a regular part of a taxpayer's unitary business. For income earned from intangibles (in this case dividends, interest and capital gains earned from shares of stock) to be part of a taxpayer's unitary income subject to apportionment, functional integration between the business activities of the payor and the activities of

the payee is not a constitutional requirement. (b) The Idaho court's ruling that ASARCO had failed to prove by clear and convincing evidence that the income at issue here was separate from its unitary business or that the income attributed to Idaho is not rationally related to intrastate values is supported by the record and, therefore, should be affirmed.

(A) Apportionment of income from intangibles is constitutionally permitted when the intangibles are held and used as part of the taxpayer's unitary business.

ASARCO's opening brief does not clearly explain the principal difference between the parties on this due process issue. ASARCO contends that the operating business relationships between ASARCO and each of the dividend payor corporations are insufficient to conclude that these companies are together engaged in a single unitary business. Accordingly, ASARCO contends that neither (a) the dividends nor (b) interest received from these corporations and the gain on disposition of their stock can be classified as apportionable business income by Idaho. We contend that the fact that ASARCO's acquisition, management and disposition of these intangible assets were regular parts of ASARCO's own unitary business disposes of the due process issue. The shares of stock were held for business purposes relating to ASARCO's unitary business of mining, smelting and refining non-ferrous metals. This integration—i.e., between the business use of the intangible assets and ASARCO's mining, smelting and refining business—supports treating the contested income as unitary business income subject to apportionment and satisfies the requirements of the Due Process Clause.[3]

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3 When, in this brief, we speak of apportioning ASARCO's income, we are talking about the income of the combined

(Continued on next page)

The constitutional principles, which ASARCO does not challenge, are well established. First, the income of a business operating in interstate commerce is not immune from fairly apportioned state taxation. *Northwestern States Portland Cement Company v. Minnesota*, 358 U. S. 450, 458-462 (1959); *Underwood Typewriter v. Chamberlain*, 254 U. S. 113, 120 (1920); *United States Glue Company v. Oak Creek*, 247 U. S. 321, 328-329 (1918). Second, "[T]he entire net income of a corporation generated by interstate as well as intrastate activities, may be fairly apportioned among the States for tax purposes by formulas utilizing in-state aspects of interstate affairs." *Northwestern States Portland Cement Company v. Minnesota, supra* at 460. Third, before a state may tax income generated in interstate commerce, the Due Process Clause requires both a "minimal connection" between the interstate activities and the taxing state, and a rational relationship between the income attributed to the state and the intrastate values of the enterprise. *Moorman Mfg. Company v. Bair*, 437 U. S. 267, 272-273 (1978); *Mobil Oil Corp. v. Commissioner of Taxes of Vermont*, 445 U. S. 425 (1980). When income is earned from activities which are part of a unitary business conducted in several states, then the requirement that the income bear relation to the benefits and privileges conferred by the several states has been met. "These are the circumstances in which apportionment is ordinarily the accepted method." *Mobil, supra* at 445-446 and *Exxon Corp., supra* at 229. In order to carve out an exception of some income from apportion-

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group of ASARCO and the six combined subsidiaries. The income being apportioned is the combined income of all seven entities, and the apportionment factor is computed by using the property, payroll and sales of all seven. (J. S. App. p. 44a and J. A. pp. 55a-81a).

ment, the test established in *Mobil* was: "[A]ppellant must demonstrate something about the nature of this income that distinguishes it from operating income, a proper portion of which the State concededly may tax." *Mobil* at 437-438. In *Mobil* this Court found no such distinction. Finally, this Court has held that a taxpayer who attacks an apportionment formula carries a distinct burden of showing by "clear and cogent evidence" that it results in extraterritorial values being taxed. *Butler Bros. v. McColgan,* 315 U. S. 501 (1942).

The Idaho Supreme Court, after reviewing the factual record, simply concluded that ASARCO had not established that this contested income from intangibles was separate from its operating income. ASARCO had failed to clearly separate this contested income from its other operating income. The Idaho Court said:

> With respect to the dividends ASARCO received from Southern Peru Copper Corp.; M. I. M. Holdings, Ltd.; General Cable; Revere Copper; ASARCO Mexicana, S.A.; and Compania American Smelting, S. A., we conclude that the record does not contain clear and convincing evidence to rebut the statutory presumption and does not support the trial court's finding that those dividends were not business income.[4] For the years in question ASARCO owned a controlling or at least a very substantial interest in each of these corporations. They are all engaged in businesses closely related to ASARCO's mining and smelting operations and, with the exception of M.I.M., ASARCO did a substantial amount of business with them and provided them with a variety of technical services. The clear inference from these

4 The uniform act (UDITPA) uses the term "business income" to refer to income to be apportioned. The term "non-business income" refers to income allocated to a specific state rather than apportioned. (See *Idaho Code* § 63-3027 (a) at J. S. App. pp. 67a-68a).

> facts is that ASARCO's interest in these companies was not merely that of a passive investor but that this dividend income arises from ASARCO's mining and smelting business and that ASARCO acquired and maintained its ownership interest in these companies as an integral and necessary part of its mining and smelting business. We recognize that M.I.M., for the years in question, seems to have operated independently of ASARCO and did little if any business with ASARCO. Although ASARCO owns a controlling interest in M.I.M., ASARCO did not exercise its right to control the corporation, apparently for political reasons. Nevertheless, ASARCO does own a majority of M.I.M. stock and M.I.M. is engaged in virtually the same business as ASARCO. Given these facts and the statutory presumption we conclude that the trial court erred in concluding that ASARCO's interest in M.I.M. was merely a passive investment unrelated to ASARCO's mining and smelting business. [J. S. App. pp. 22a-23a]

The Idaho Supreme Court did not permit the Idaho Tax Commission to apportion *all* of ASARCO's income from intangibles as the Commission had originally attempted to do. After careful consideration of the evidence, the Idaho Court concluded that ASARCO had clearly and convincingly established its ownership of shares of stock in some companies was not related to its mining and smelting business. [J. S. App. p. 23a]. These conclusions were part of the Idaho court's analysis of the statute. However, in its consideration of the constitutional issues, the Idaho court correctly perceived that the UDITPA provisions clearly conform to the requirements of the Due Process Clause. The court said:

> We believe that any constitutional limitations upon a state's right to apportion the intangible income, including dividends, of a multistate corporation doing business within the state are satisfied by the Idaho statutory requirement that the acquisition, manage-

> ment or disposition of the underlying asset must be an integral or necessary part of the taxpayer's unitary business, a part of which is conducted in this state. [Citations omitted] [J. S. App. p. 28a]

Thus, the Idaho court sustained the apportionment of intangibles, or income from intangibles, which it found were an integral part of a taxpayer's unitary business. Such apportionment of intangibles is neither new nor unique.[5] The unitary business principle has its beginnings in the ad valorem taxation of railroads, express companies, and similar interstate businesses. In the early case of *Adams Express Company v. Ohio State Auditor*, 165 U.S. 194 (1897), *rehearing denied* 166 U.S. 185 (1897), the court squarely addressed the apportionment of intangibles. In denying the express company's petition for rehearing, the Court, in 166 U. S. at 223, said:

> Where is the situs of this intangible property? Is it simply where its home office is, where is found the central directing thought which controls the workings of the great machine, or in the State which gave it its corporate franchise; or is that intangible property distributed wherever its tangible property is located and its work is done? Clearly, as we think, the latter.

This rule was later extended from property taxes to corporate privilege and income taxes. In *Flint v. Stone Tracy Co.*, 220 U. S. 107 (1911), the court stated:

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5 The terms "operating income" and "income from intangibles" imply a distinction that is inaccurate and misleading. The fact is, much of any company's operating income is from intangibles. The commonly used three factor apportionment formula determines income based upon a taxpayer's property, payroll and sales. This assumes that a taxpayer earns its income from the use of real and tangible personal property, the use of labor and the use of the marketplace. Two of these three elements—labor and the market—are themselves intangibles. The formula measures "wherever its tangible property is located and where its work is done." *Adams Express, supra*, 166 U. S. at 223.

> Nor can it be justly said that investments have no real relationship to the business transacted by a corporation. The possession of large assets is a business advantage of great value; it may give credit which will result in more economical business methods, it may give a standing which shall facilitate purchases, it may enable the corporation to enlarge the field of its activities and in many ways give it business standing and prestige. (220 U. S. at 166)

In *Ford Motor Company v. Beauchamp*, 308 U. S. 331 (1939), this court again recognized that intangible properties contribute substantially to the business activities of multistate and multinational corporations conducted in various states:

> In a unitary enterprise, property outside of the state necessarily affects the worth of the privilege within the state. Financial power inherent in possession of assets may be applied, with flexibility, at whatever point within or without the state the managers of the business may determine. For this reason, it is held that an entrance fee may be properly measured by capital wherever located. The weight, in determining the value of the intrastate privilege, given the property beyond the state boundaries, is but a recognition of the very real effect its existence has on the value of the privilege granted within the taxing state. (308 U. S. at 336)

In *Underwood Typewriter Company v. Chamberlain*, 254 U. S. 113 (1920), a tangible property apportionment factor was used to apportion to Connecticut a part of Underwood's entire federal taxable income including income from intangibles. In challenging the constitutionality of the apportionment formula, the taxpayer contended, in part, that the net income included income from intangibles not connected with its Connecticut manufacturing business or properties. Relying upon the concepts underlying the unitary business principle and focusing upon the validity

of the apportionment result, the court upheld Connecticut's apportionment of all Underwood's federal taxable income, including income from intangibles.

A number of cases hold that intangibles used by a business as a necessary or integral part of the business are taxable where the business activity relating to the intangibles occurs. See *First Bank Corp. v. Minnesota*, 301 U. S. 234, 236 (1937); *Wheeling Steel Corp. v. Fox*, 298 U. S. 193, 210 (1936); *Farmers Loan & Trust Co. v. Minnesota*, 280 U. S. 204, 213 (1930); *Beidler v. South Carolina Tax Commission*, 282 U. S. 1, 8 (1930); *First National Bank v. Maine*, 284 U. S. 312, 331 (1932). The rationale of these cases is that intangibles have their situs where the business activities to which they relate occur. However, if that business is a unitary business conducted in more than one state, then "the circumstances in which apportionment is ordinarily the accepted method" exist. *Mobil, supra* at 445-446 and *Exxon Corp., supra* at 229. Clearly, where the intangibles are part of the taxpayer's unitary business, the income earned from the intangible is no different than any other kind of operating income and it is subject to apportionment. The effect of ASARCO's position is to ask this Court to impose a different due process standard in the case of income earned from stockholdings than applies to other forms of income earned from intangibles. Nothing in *Mobil* justifies applying different due process standards to different kinds of income.

In all of the foregoing cases, intangibles were found to be part of a taxpayer's unitary business based upon the relationship between the intangible asset and the taxpayer's business. In *Mobil*, the Court looked to functional integration between Mobil's operations and the business operations of the dividend-paying subsidiaries in order to

conclude that there was a connection between the intangible assets held by Mobil which generated the income and Mobil's unitary business, a part of which was conducted in Vermont.[6] In so doing, the Court did not in any way modify or overrule any of the older cases cited above. In short, "functional integration" is not and cannot be the exclusive test for determining whether dividend income may be subjected to apportionment.

This Court's most recent decision, *Exxon Corporation v. Wisconsin Dept. of Revenue,* 447 U.S. 207 (1980), strongly supports this conclusion. In that case, this Court sustained Wisconsin's inclusion of all Exxon's functional departments as part of its unitary business subject to apportionment. These functional departments included exploration and production, refining, marketing, marine, coal and shale oil, minerals and land management. Only Exxon's marketing division conducted business in Wisconsin. However, because the activity conducted inside the state was part of Exxon's unitary business and because each of the activities conducted outside the state were also a part of that unitary business, apportionment of all of the income from all of these activities was sustained. In the present case, one of ASARCO's activties, conducted outside Idaho, is the acquisition, management and sale of certain intangible assets resulting in income in the form of dividends, interest and capital gains. The Idaho Supreme Court has similarly concluded that these activities are sufficiently related to ASARCO's other business activities, a part of which are conducted in Idaho, to make them part of ASARCO's unitary business and to justify

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6 As the dissenting opinion in *Mobil* observed (see footnote 9 at p. 456), several of the dividend-payor corporations would indeed appear to be companies not engaged in a unitary business with Mobil Oil Corp.

apportionment of that income. Substantial evidence from the record supports that conclusion. (See part I. (B), *infra*).

In summary, Idaho apportions all business income because the uniform act (UDITPA) does not attempt to locate business income by a geographical source, but rather attributes it by formula to where the taxpayer's underlying business is conducted as reflected by its tangible property, payroll and sales. Intangible properties by their very nature have no fixed situs. When intangibles are utilized in the taxpayer's business operations, it is perfectly reasonable and logical to attribute income derived from them to states where the business to which they are related is actually conducted by the taxpayer. This is all that UDITPA does. When income from intangibles is properly classified as apportionable business income under UDITPA, the due process connection is satisfied because that classificiation properly associates this income to the unitary business and apportions it to states where the unitary business is conducted.

(B) The evidence supports the Idaho Court's conclusion that ASARCO failed to prove by clear and cogent evidence that the income in question was separate from its unitary business.

In holding that the income from intangibles was statutorily and constitutionally apportionable, the Idaho court concluded that ASARCO had failed to prove by clear and convincing evidence[7] that these intangibles were not ac-

7 The Idaho statute requires that certain classes of income (including those at issue here) be presumed to be business income subject to apportionment unless shown to the contrary by "clear and convincing evidence." [*Idaho Code* § 63-3027 (a) (1). J. S. App. p. 67a] We believe this evidentiary standard is no different from the "clear and cogent evidence" standard set by this Court in *Butler Bros., supra,* and repeatedly applied since.

quired, managed and disposed of as a regular part of its trade or business. In so concluding, the court relied upon substantial evidence from the record. In regard to the five corporations whose dividends are challenged by ASARCO in this appeal, that record reflected the following:

Southern Peru Copper Corporation

This is an American corporation whose activities are confined to Peru in which ASARCO owned 51.5 percent. Minority shareholders were Phelps Dodge—16 percent; Newmont Mining—10.25 percent; and Cerro Corporation —22.5 percent. (J. A. p. 86a). ASARCO is a major customer of Peru Copper Corporation and that corporation is also an important supplier of raw materials to ASARCO. (J. S. pp. 43a-47a and p. 89a). Southern Peru produces blister copper, 20 to 30 percent of which is sold in Europe by the Southern Peru Copper Sales Corporation. (J. S. pp. 43a-47a and p. 89a). [The sales corporation is a tax device known as a western hemisphere trading corporation insulator. It allowed Southern Peru Copper Corporation to retain its favored federal tax treatment as a western hemisphere trading corporation. (Rptr's Tran. p. 119). The sales corporation's ownership is the same as that of Southern Peru (J. A. p. 86a), but it has no employees. All of its activities are performed by ASARCO's employees. (J. A. pp. 86a and 90a).] Of the production not sold in Europe, ASARCO receives 51.5 percent—a proportion equal to its ownership. (J. A. p. 86a). For the tax years in question (1968-1970), Southern Peru's sales to ASARCO ranged from amounts in excess of $49 million to amounts in excess of $64 million. (J. A. p. 89a).

ASARCO is entitled to elect six of the company's thirteen directors. Six more are elected by the other

shareholders and the remaining director is appointed by either the other directors or all the shareholders.[8] The testimony established that Southern Peru is an "important" source of raw materials for ASARCO. If it lost this source of supply, it would either have to replace it or be satisfied with a reduced volume of business.[9]

M. I. M. Holdings, Ltd.

ASARCO owned a controlling interest in this company which is engaged in mining, smelting and refining of nonferrous metals in Australia and operates a refinery in England. (J. A. pp. 86a-87a). ASARCO did not maintain any common officers or directors of M.I.M. but ASARCO's comptroller testified that this was only because the company operated successfully with Australian nationals and, therefore, ASARCO chose not to exercise its right to elect directors. (J. A. pp. 132a-133a). The company used ASARCO's furnace patent and obtained technical services from ASARCO. (J. A. pp. 133a-134a). It is engaged in exactly the same kind of business activity in Australia and England that ASARCO conducts in the United States. (J. A. pp. 134a-135a). Because shipping concentrates from Australia to the United States is not economic, in two of the three taxable years M.I.M. made only a little more than one percent of its total sales to ASARCO. (J. A. pp. 43a-47a).

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8 The record is in conflict on this point, indicating at one place the shareholders jointly select the 13th director (J. A. p. 91a) and at another point that the other 12 directors make the selection (J. A. p. 121a).

9 ASARCO's ownership of 51.5% of the stock in Southern Peru Copper Corp. is strikingly similar to Mobil's 10% ownership of the Arabian American Oil Co. (ARAMCO). See *Mobil, supra,* n. 5 at 430. Both companies serve as sources of raw materials for the shareholder's principal business in the United States.

General Cable Corporation and Revere Copper and Brass, Incorporated

General Cable and Revere Copper are customers of ASARCO (J. A. p. 27a) in which ASARCO owned approximately 34 percent of the stock. (J. A. pp. 29a and 135a). The remaining stock is widely held. (J. A. p. 135a). Revere Copper used an ASARCO patent and utilized ASARCO's stock transfer department. (J. A. p. 136a). These fabricators lacked their own source of raw materials. (J. A. p. 96a). The auditor's narrative (which the parties prior to trial stipulated was correct—J. A. 26a) concludes that the acquisition of this stock was "business motivated" in part because ASARCO voted its significant stock-holdings prior to being prohibited from doing so by the U. S. Justice Department (J. A. pp. 95a-96a). General Cable purchased from $30 to $45 million of ASARCO's product and Revere between $16 and $30 million of products each year. (J. A. pp. 43a-47a) ASARCO's controller admitted that these companies "make significant purchases from ASARCO" (J. A. p. 137a) and were "major customers" of ASARCO. (Rptr's Trans. p. 108).[10]

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10 The record refers to the anti-trust litigation brought against ASARCO relating to its holdings in General Cable and Revere Copper. (J. A. p. 95a) The case is *United States v. American Smelting and Refining Co., et al.*, Dk. No. 61 CIV 241 United States District Court, Southern District of New York. Part of the record there includes a "statement of consideration for the Support of Settlement of the Action" submitted jointly by counsel for the government and ASARCO's counsel. It states in part,

> . . . ASARCO's investments in Revere and Cable make a substantial contribution to ASARCO's financial strength, both because of the income that these investments produce and because by contributing to ASARCO's credit standing they facilitate the raising of capital for new investment.

ASARCO Mexicana, S. A.

This company mines and smelts lead and copper in Mexico. (J. A. p. 87a). ASARCO owns 49 percent of the stock. (J. A. p. 29a). The remainder is publicly held by Mexican nationals. At one time, ASARCO owned 100 percent of the company but in 1965 was required by Mexican law to divest itself of 51 percent of the stock. (J. A. pp. 129a-130a). ASARCO provides the company with technical services and acts as a sales agent for the company's sales outside of Mexico. (J. A. pp. 87a, 130a-131a). The corporation also uses ASARCO's valuable trademarks and tradenames. (J. A. p. 129a).

> Clearly, the Idaho Supreme Court's findings that . . .
>
> . . . ASARCO's interest in these companies was not merely that of a passive investor but that this dividend income arises from ASARCO's mining and smelting business and that ASARCO acquired and maintained its ownership interest in these companies as an integral necessary part of its mining and smelting business [J. S. App. p. 22a] . . .

is supported by substantial evidence in the record.[11]

Interest income and gains were earned from these same intangibles (J. A. pp. 51a-53a), therefore, the same result should obtain (See generally J. A. pp. 83a-96a). See *Xerox Corp. v. Comptroller of the Treasury*, 428 A. 2d 1208 (Ct. App., Md., 1981). Because there is evidence in the record to support the Idaho court's factual finding, this Court should not disturb that finding on appeal. *Cali-*

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11 The Idaho Supreme Court is not alone in its finding that the income was earned as a regular part of ASARCO's trade or business. The Montana Supreme Court reached the same conclusion in regard to the same taxpayer for the same taxable periods. *Montana Dept. of Revenue v. American Smelting & Refining Company*, 567 P. 2d 901 (Mont., 1977), appeal dismissed 434 U. S. 1042 (1978). The Montana assessments at issue in that case resulted from the same MTC audit upon which the Idaho assessments are based.

fornia Retail Liquor Dealers Assn. v. Mideal Alum, — U. S. —, 100 S. Ct. 937 at 947 (1980); *Lloyd A. Fry Roofing Co. v. Wood*, 344 U. S. 157, 159-160 (1952); *First National Bank v. Louisiana Tax Commission*, 289 U. S. 60, 65-67 (1933); *Evco v. Jones*, 409 U. S. 91, 94 (1972).

To sustain its due process challenge, ASARCO must also show that the amount of income Idaho seeks to tax has no rational relationship to the intrastate values of the enterprise. *Moorman Mfg. Co. v. Bair, supra* at 272-273; *Mobil, supra*. ASARCO's entire case at the trial was based upon its own internal separate accounting. These separate accounting computations attributed losses to ASARCO's activities in Idaho (J. A. pp. 39a-40a). No other factual showing of purported overreaching by Idaho was attempted. A taxpayer's internal separate accounting records as a basis for impeaching a state's method of apportioning income has been uniformly rejected by this Court every time it has been raised. In *Underwood Typewriter Company v. Chamberlain*, 254 U. S. 113, 121 (1920), Mr. Justice Brandeis recognized "the impossibility of allocating specifically the profits earned by the processes conducted within its borders." In *Butler Bros. v. McColgan*, 315 U. S. 501 (1942), the court stated:

> [W]e need not impeach the integrity of that accounting system to say it does not prove appellant's assertion that extraterritorial values are being taxed."

In *Mobil, supra*, the Court recognized that:

> Separate accounting, while it purports to isolate portions of income received in various States, may fail to account for contributions to income resulting from functional integration, centralization of management, and economies of scale.

Separate accounting as a method of impeaching the state's apportionment result was again rejected in *Exxon*

Corp. v. Wisconsin Dept. of Revenue, 447 U. S. 207 (1980). *See also* Dexter, "The Unitary Concept in State Income Taxation of Multistate-Multinational Business" 10 *The Urban Lawyer* 181 (1978).

Accordingly, ASARCO's effort to discredit Idaho's apportionment result by means of its separate accounting evidence is inadequate and was recognized as such by the Idaho Court (J. A. App. 30a-31a).

Idaho has instead apportioned income based on the amount of ASARCO's income producing activity in Idaho as compared to its income producing activity everywhere—measured by its property, payroll and sales. Because by this measure approximately 2.5% of ASARCO's activity occurs in the state (J. A. pp. 59a, 67a, 75a), Idaho has taxed approximately 2.5% of its income.[12] Nothing about this apportionment has been shown to be unreasonable.[13]

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12 This approximate 2.5% Idaho apportionment factor is a maximum. The amount of the sales factor under Idaho law remains an unresolved issue which the Idaho Supreme Court remanded to the district court for further consideration. (J. S. App. pp. 33a-35a).

13 Instead, the amount of income attributed to Idaho (even before reduction to reflect the income found by the Idaho Court to be non-apportionable) seems entirely consistent with reasonable expectations. Measured as a return on ASARCO's original investment in Idaho property, it is a modest annual return of less than 12%. This return is computed as follows (parentheticals refer to pages of the Joint Appendix):

Year	Idaho Property	Idaho Income	Return (%)
1968	$14,948,099 (63a)	$1,541,198 (59a)	10.31%
1969	15,091,707 (71a)	2,274,750 (67a)	15.07%
1970	20,436,788 (79a)	2,162,346 (75a)	10.58%
Total	50,476,594	5,978,294	11.84%

When the Idaho income figures are recomputed to reflect exclusion of income classified as non-apportionable by the Idaho court and any reductions to the Idaho sales factor that may result from the Idaho court's remand of that issue, the return percentages computed above will be smaller.

Accordingly, this Court should affirm that the decision of the Idaho Court complies with the requirements of the Due Process Clause of the Fourteenth Amendment.

II.

The Standard Three Factor Formula provided by UDITPA and used by Idaho reaches a proper apportionment result in this case without any special adjustments being applied.

As an alternative argument, ASARCO suggests in part II of its brief that either the Due Process Clause or the Foreign Commerce Clause require that the factors used to apportion income must be modified to reflect the activities of the dividend payor corporation. These positions are both unsupported by any acceptable evidence and misapply this Court's ruling in *Mobil*. Because the unitary income is ASARCO's own income, it need only be apportioned based upon ASARCO's own business activities. That is the result accomplished by application of the standard three factor formula. The Due Process Clause requires no more. In fact, the adjustments proposed by ASARCO achieve illogical results which are contrary to the unitary business principle and inconsistent with the Due Process Clause. ASARCO's commerce clause challenge was fully considered and rejected by this Court in *Mobil*. Despite ASARCO's attempt to distinguish its issue from that decided by this Court in *Mobil*, there is no real difference.

(A) Nothing in the Due Process Clause requires that the UDITPA apportionment factors be modified in this case.

ASARCO contends that if the questioned dividends are apportioned, then the Due Process Clause requires that certain adjustments be made to the property, payroll and sales factors used to apportion that income. Specifically, ASARCO contends that a part of the property, payroll

and sales of the dividend-payor corporations must be added to the denominators of its own apportionment factors (See Appellant's brief, pp. 27-37). ASARCO premises its position on two demonstrably false premises: first, that this Court in *Mobil, supra,* prohibited the apportionment of dividends unless they are received from a corporation conducting a business functionally integrated with the payee; and, second, that this Court's conclusions in *Mobil, supra,* require apportionment formula results which approximate a result comparable to a "combined report" of taxable income.

We have already discussed in part I of this brief the appropriate constitutional criteria for apportioning dividends and other income from intangibles. We have demonstrated that the apportionment depends upon the relationship between the acquisition, management and disposition of the intangible asset and the overall unitary business activities of the payee corporation. We will discuss later in this part of this brief the relationship between the apportionment of dividends and "combined reporting."

In addition to these points, it is important to recall ASARCO's burden. ASARCO must show, by clear and cogent evidence, that the apportionment method used by the state clearly results in the taxation of extraterritorial values. *Butler Bros. v. McColgan, supra,* 315 U. S. at 507. As we observed earlier, the only evidence submitted by ASARCO at the trial was based upon its internal separate accounting results. A taxpayer's internal separate accounting is, as we have shown before, insufficient to impeach the state's apportionment result (See part I(B) above). Appellant argues that, because apportionment results in an amount of income attributable to Idaho substantially more than its separate accounting records indi-

cate is proper, the apportionment must be "inherently arbitrary" and therefore unconstitutional (See Appellant's brief, pp. 36-37). Nothing further by way of proof of taxation of extraterritorial values is offered either in Appellant's brief or anywhere else in the record in this case. Accordingly, the Idaho Court correctly concluded that this separate accounting analysis does not sustain the required burden (J. S. App. p. 31a). The taxpayer must make a factual showing which meets the clear and cogent evidence rule. Any adjustments to the apportionment factors which may be appropriate are not required automatically as a matter of law. Otherwise, Mobil Oil Corporation would have been entitled to such adjustments even though it attempted no factual showing of disproportionate taxation by Vermont. It was this lack of showing which—at least in part—caused this Court to defer ruling on the issue in that case. (See *Mobil,* supra, n. 16 at p. 442 ". . . the absence of evidence in the record to decide the issues on which the dissent speculates . . . cuts against and not in favor of appellant's cause.") If this Court rejects—as the Idaho court correctly did—ASARCO's separate accounting evidence, the record in this case is equally devoid of any attempt to show taxation of extraterritorial values.

In any event, there is nothing conceptually inconsistent about applying the UDITPA apportionment formula, without adjustment, to income earned from intangibles acquired, managed and disposed of as a regular part of a taxpayer's unitary trade or business. First, ASARCO cannot ignore the fact that it is a separate and distinct taxpayer from the dividend-payor corporations and that the taxation of dividends is distinct and separate from the taxation of the underlying profits of the payor corpora-

tions. See *Moline Properties, Inc. v. Commissioner,* 319 U. S. 436 (1943); *In re Goodyear Tire & Robber Company,* 133 Vt. 132, 335 A. 2d 310 (1975); and *Gulf Oil Corp. v. Morrison,* 120 Vt. 324, 141 A. 2d 671 (1958). The Idaho court's decision correctly perceives this important legal principle. The Idaho court ruled:

> The commission did not levy a tax upon the income of the dividend-paying corporations; rather, it levied a tax upon ASARCO's income. Those dividends are clearly part of ASARCO's income and it is unquestioned that there is a sufficient connection between ASARCO and this state to constitutionally permit the state to tax its proper share of ASARCO's income. If the due process clause were to prohibit the inclusion of dividends in a taxpaytr's taxable income unless the payor corporation also conducts business within the taxing state, the due process clause would logically also prohibit the taxpayer's domicile from taxing those dividends if the payor corporation did not conduct its business within the domiciliary state, and indeed it would prohibit the United States and any state from ever taxing dividends paid the taxpayer by a corporation whose activities are located entirely without this country. The due process clause simply does not limit the right to tax dividends paid a taxpayer to the jurisdictions in which the payor corporation conducts its business. We believe that any constitutional limitations upon a state's right to apportion the intangible income, including dividends, of a multistate corporation doing business within the state are satisfied by the Idaho statutory requirement that the acquisition, management or disposition of the underlying asset must be an integral or necessary part of the taxpayer's unitary business, a part of which is conducted in this state. [Citations omitted] [J. A. App. p. 28a].

This Court in *Mobil* did suggest that some apportionment relief may be required if the dividends are from payor corporations which conduct an integrated unitary business

with the payee corporation. The Idaho statutory scheme —and indeed the decisions of both the Idaho trial court and the Idaho Supreme Court in this case—recognizes the activities of the functionally integrated subsidiaries. The State District Court concluded that six of ASARCO's wholly owned subsidiaries conducted a unitary business with ASARCO and, therefore, combination of these subsidiaries was necessary to "accurately reflect plaintiff's income within the state of Idaho" (J. S. App. pp. 44a and 36a). ASARCO did not appeal that determination.[14] Although this Court did not address the validity of combined reporting in its *Mobil* decision, it did recognize that,

> "A necessary concomitant of [combination] would be inclusion of the subsidiaries' and affiliates' sales, payroll, and property in the calculation of the apportionment formula . . . the result, presumably, would be advantageous to appellant, since virtually nothing would be added to the 'Vermont' numerators of the apportionment factors, while there would be substantial increases in the 'everywhere' denominators, resulting in a diminution of the apportionment fraction." (See *Mobil, supra,* n. 15 at p. 441).

Idaho statutorily provides for combined reporting. See *Idaho Code* § 63-3027(s) (J. S. App. p. 73a). The Idaho court explained that this section applies when several corporations are engaged in a functionally integrated business activity. The Idaho court said:

> The combined reporting provision of subsection (s) is a further refinement of the basic apportionment principle. Its purpose is to permit application of the UDITPA apportionment formula to a single business

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14 The validity of the "combined report" is before this Court in the case of *Chicago Bridge and Iron, et al. v. Caterpillar Tractor Co., et al.,* Prob. juris. noted — U. S. — Nov. 9, 1981, Dk No. 81-349 U. S. Supreme Court, which is to be heard the same day this case is argued.

> enterprise which is conducted by means of separately incorporated entities. [citation omitted] In an economic sense, such a business is no different than a similar business composed of a single corporation with several separate divisions. [citations omitted] (J. S. App. 21a).

Therefore, the Idaho statutory scheme, as interpreted and applied by the Idaho courts, provides apportionment modification when two or more corporations are engaged in a single unitary business. This is precisely the circumstance in which ASARCO contends that apportionment modification is required. However, ASARCO admits that the five dividend payor corporations at issue in this appeal are *not* conducting a unitary business with ASARCO. (Appellant's brief, pp. 18-25). Because these companies were not engaged in a single unitary business together with ASARCO, including them in a combined report is inappropriate. *Edison California Stores, Inc. v. McColgan,* 176 P. 2d 697 (Calif., 1947). Instead, as we have shown, because the intangible assets generating this income were related to ASARCO's own unitary business, the dividends may be apportioned among those states in which ASARCO's unitary business is conducted. Because the unitary business is ASARCO's business—not the payor corporation's business—reflecting the payor's property, payroll and sales in the payee's apportionment formula is illogical.[15]

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15 We do not intend to imply that adjustment of the apportionment factors is required in a state (such as Vermont) not recognizing the combined reporting method. Instead, Idaho's statutory scheme provides for combined reporting in the case of corporations conducting a single unitary business in more than one state. This system recognizes the property, payroll and sales of all the corporations included in the unitary group. This aspect of the Idaho statute refutes ASARCO's claim that Idaho does not recognize the

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Combining, for income tax reporting purposes, and apportioning income earned from business assets are conceptually distinct and are intended to achieve different results. We cannot improve on the Idaho court's explanation of this legal distinction. That court said:

> . . . [T]he district court seems to have concluded that since the corporations which paid the dividends were not sufficiently connected with ASARCO's business operations to justify combining those corporations with ASARCO for tax reporting purposes pursuant to I. C. § 63-3027 (s), the stock ASARCO owned in those corporations was *ipso facto* not an integral or necessary part of ASARCO's trade or business so as to justify including the dividends they paid ASARCO as part of ASARCO's apportionable business income under I. C. § 63-3027(a)(1). When corporations are combined under subsection (s) for tax reporting purposes, the dividends paid one corporation by the other are not considered income but, as the commission did in this case, are properly treated as intracompany transfers. The district court's reasoning, therefore, would preclude dividends from ever being classified as business income and is thus clearly inconsistent with subsection (a)(1) which presumes that dividends are business income. The effect of this reasoning would nullify the statutory provision, a result we must avoid if possible. [Citation omitted]
>
> However, these provisions are not necessarily inconsistent. They have different objectives and they can be read harmoniously if those objectives are kept in mind. The combined reporting provision of subsection (s) is a further refinement of the basic apportionment principle. Its purpose is to permit appli-

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income-producing activities of unitary subsidiaries. The combined reporting method is, for a number of reasons, superior to attempting to adjust the apportionment factors. (See, *infra*, pp. 32-38) If recognition of the income-producing activities of a unitary subsidiary is constitutionally required, then this Court should require the use of combined reporting rather than the adjustment of apportionment factors.

cation of the UDITPA formula to a single business enterprise which is conducted by means of separately incorporated entities. [Citation omitted] In an economic sense such a business is no different than a similar business composed of a single corporation with several separate divisions. [Citations omitted] For tax reporting purposes such businesses should be treated the same. [Citations omitted]

In contrast, subsection (a)(1), which authorizes the apportionment of a taxpayer's dividend income in certain circumstances, addresses a very different question. While the combined reporting provision concerns a proper identification of the contours of the business enterprise, the business income definition of subsection (a) (1) concerns the differentiation between truly passive investment income and income which is incidental to or connected with the taxpayer's business operations. These are two related but conceptually and legally very different questions. Simply because the management, operation and activity of a corporation in which the taxpayer owns stock is not so closely connected with the management, operation and activities of the taxpayer to warrant a combined tax return, does not *ipso facto* mean that the dividends the taxpayer receives from that stock cannot be "income arising from transactions and activities in the regular course of the taxpayer's trade or business" and that the "acquisition, management, or disposition" of the stock does not "constitute integral or necessary parts of the taxpayer's trade or business operations." I. C. § 63-3027 (a) (1). The combined reporting provision and the business income definition serve different purposes, ask different questions and apply different standards. The answer to one does not necessarily imply the same answer to the other. (J. S. App. pp. 20a-22a).

See also: Keesling, "A Current Look at the Combined Report and Uniform Allocation Practices", 41 J. Tax. 106 (1975).

In summary, the only basis for the factor adjustments proposed by ASARCO is its position that dividends cannot

be apportioned unless the payor and the payee are together engaged in a unitary business. As we have shown, the Due Process Clause does not limit apportionment of dividends to that circumstance. Under the statutory scheme in Idaho, corporations engaged in a unitary business will be combined. Intercompany dividends and other payments will be eliminated and the factors of all members of the unitary business will be reflected in the apportionment formula. Income from intangibles which is earned as a regular part of that unitary business will be apportioned by formula to all of the states (and foreign jurisdictions) in which the unitary business conducts its activities. These are the two different aspects of the unitary business principle. Combined reporting defines the identity of the unitary business (which is made up of two or more corporations). The definition of apportionable business income determines the amount of income earned by that unitary business which may be apportioned.

ASARCO's suggested adjustments to the apportionment factors would lead to highly anomalous results. The practical substantive result would be to virtually exempt dividends from state taxation if the ratio of the property, payroll and sales of the payor corporation to that income equal the same ratio of the payee corporation. To the extent that this ratio of the payor exceeded that of the payee, it would reduce income of the payee attributable to the taxing state below that otherwise attributable if the dividends had been excluded from taxable income.

The following example illustrates this anomaly:

> Assume a corporation, "Parent A", has net income of $1,500; $500 of which is dividends from its 50% ownership in "Subsidiary B." If an average 10% of A's activities, as measured by the extent of its property, payroll and sales, are in Idaho, it will have a

10% total Idaho apportionment factor. Application of that factor to the income subject to apportionment yields $100 of net income attributable to Idaho if the dividends are excluded from apportionable income and $150 if dividends are apportioned. Assume further that Subsidiary B has no business activities in Idaho but does have a net income of $2,000 from which its dividends were paid. Sudsidiary B also has $2,000 each of property, payroll and sales—all outside of Idaho. Addition of any part of its property, payroll or sales to the computation of Parent A's Idaho apportionment factor will result in obvious distortion. Parent A's apportionment factor for Idaho is computed as follows:

Factors of the Formula	Amount Everywhere	Amount in Idaho	Idaho Percentage
Property	$1,000	$ 50	5%
Payroll	1,000	100	10%
Sales	1,000	150	15%
Total Idaho apportionment factor (Average)			10%

Income apportioned to Idaho:

(A) With dividends: $1,500 x 10% = $150
(B) Without dividends: $1,000 x 10% = 100

If the apportionment formula of Parent A is modified, as ASARCO says is constitutionally required, the everywhere amounts of the property, payroll, and sales factors of Parent A would each be increased by $500 since each of B's factor is $2,000 and 25% of these factors would be includable in the denominators of Parent A since the dividends of Parent A equal 25% of the profits of Subsidiary B.

This would result in attributing 1/15th of Parent A's net income of $1,500 to Idaho or *$100*—The exact result that would be achieved if the dividends were excluded from Idaho apportionable income or exempt.

In the foregoing example, if the everywhere property, payroll and sales of Subsidiary B are assumed to each be $2,400, the net income apportioned to Idaho, by inclusion of dividends, under ASARCO's argument, would be 1/16th

of $1,500 or $93.75. This is $6.25 *less* than if dividends are totally excluded from apportionable income or exempt.

This example illustrates a basic fallacy of the adjustment to the apportionment factors ASARCO argues is constitutionally required. The inclusion of dividends in apportionable income is *not* the taxation of the underlying profits of the payor corporations. The *Mobil* Court specifically held that Vermont was entitled to tax a share of the dividends as part of Mobil's unitary income. This share cannot be zero or less than zero.

If states are entitled to include dividends in apportionable income because the stock investments are related to the unitary business of the taxpayer carried on in part in their borders (the express holding in *Mobil*), there is no logical reason why the three-factor UDITPA apportionment formula does not properly assign this income when the formula includes the factors of the taxpayer's entire unitary business.

The justification for inclusion of dividends or other income from intangibles in apportionable income is that this income is from intangibles which are related to a taxpayer's overall business activities. The apportionment formula, without modification, apportions income to those jurisdictions in which the taxpayer conducts its business activities. Income under the statute is classified as business income, subject to apportionment, *only* in circumstances in which it is properly attributable to where the taxpayer carries on its business activities. The apportionment formula assigns this income to these business activities by the property, payroll and sales factors. Reasonable and constitutional apportionment requires no more.

Another difficulty with ASARCO's proposed adjustment to the factors is that the total apportionment factor

thus computed would be applied not just to dividend income but to the taxpayer's operating income as well. If there is any logic at all (and we contend there is not) to applying the dividend payor's property, payroll and sales factors to the payee's dividend income, there is even less logic to applying a dividend payor corporation's property, payroll and sales factor to measure the payee corporation's source of operating income.

Still another conceptual difficulty is that the total dividends paid by a corporation will normally be less than the corporation's current income. The payor corporation must retain sufficient earnings to pay its foreign, federal and state taxes and to fund capital expenditures and expansions. [A factor completely ignored in the illustrations contained in ASARCO's brief (Appellant's brief, pp. 29-30).] Diviends might not be paid in the same year in which the payor corporation received the income from which the dividends arise. Occasionally, the amount of dividends might even exceed the payor corporation's current income. See Keesling "The Impact of the *Mobil* Case on Apportionment of Income" 1981 *Brigham Young University Law Review* 87 n. 37 at 102. In all of these circumstances, the property, payroll and sales factors of the payor corporation for the year in which the dividend is paid would bear no rational relationship to the amount of the dividend under any interpretation of the Due Process Clause.

Requiring ASARCO's proposed adjustments to the apportionment factors also has the effect of attributing part of ASARCO's income to jurisdictions in which it conducts no business activities and, therefore, in which it can earn no income. This problem is demonstrated by the following illustration:

Assume that Corporation X does business in two states—Idaho and Oregon. It conducts no business activities, owns no property, sells no products nor employs any person beyond the boundaries of those two states. Corporation X owns 49 percent of the stock of Corporation Y which confines all of its business activities to Wyoming. Corporations X and Y are not themselves engaged together in a unitary business but X holds its interest in Y for a clearly business purpose—e.g., assuring itself a source of raw materials.

ASARCO's contention would lead to the result that 49 percent of Corporation Y's Wyoming property, payroll and sales would be added to the denominators of Corporation X's property, payroll and sales both in Idaho and in Oregon in each year Y pays dividends to X. The Idaho numerators and the Oregon numerators would remain unchanged. These factors would then be averaged to determine the total apportionment percentage for such state. If the resulting Idaho and Oregon total apportionment factors are added together, they will not equal 100 percent. (Because the numerators of the Idaho and Oregon factors, when added together, will not equal the denominators.) But in our illustration, Corporation X conducts business activity in no state other than Idaho and Oregon. Accordingly, it must follow that all of its taxable income must be earned in those two states. What has happened to the remainder of the income? The addition of Wyoming property, payroll and sales values to Corporation X's denominators has in effect caused some of the income to be attributed to Wyoming—a state in which Corporation X has no tax situs and conducts no business activities. It seems obvious that Corporation X, because it conducts no business activities whatsoever in Wyoming, cannot be said to have earned taxable income in Wyoming. ASARCO's formula does exactly what ASARCO itself admits is unconstitutional; it attributes income to a place where it is not—and cannot be—earned.

ASARCO's brief (n. 27 at p. 33) attacks this illustration on the premise that it is entirely proper under *Mobil* for some of Corporation X's income to be attributed to Wyoming. This is a manifest distortion of the due process requirements. In the illustration, all of Corporation X's income must be earned in Idaho and Oregon. But ASARCO's apportionment formula would attribute some of X's income to Wyoming. If this were correct, then it would be possible for Wyoming to tax not only 100% of Corporation Y's net income (because Corporation Y conducts its business solely in Wyoming), but also an apportioned share of X's income (i.e., the part not attributed to either Idaho or Oregon). However, the Due Process Clause will not permit Wyoming to tax any of X's income because it has no business situs in that state, and therefore, the "minimum connection" requirement would not be met. See *Moorman Mfg. Company v. Bair*, 437 U. S. 267, 272-273 (1978).

If, in our illustration, Corporation X and Corporation Y were functionally integrated and together conducted a unitary business in Idaho, Oregon and Wyoming, then it would be appropriate for the total net income of the combined group of Corporation X and Y to be apportioned among those three states based upon the property, payroll and sales of both corporations. But in our illustration such unity of operation does not exist; instead, the intangible asset is held for a business purpose related to Corporation X's business activities in Idaho and Oregon. To apportion all of the income earned from that intangible asset to Idaho and Oregon does not offend the Due Process Clause because it attributes X's unitary income to the places where X's unitary business is conducted. That is what the Due Process Clause re-

quires and no adjustment to the formula is needed to accomplish that result.

Similarly, ASARCO here seeks in effect to attribute part of its own income to Peru, Mexico and Australia. For all that can be determined from the record, these are jurisdictions in which ASARCO conducts little or no business activities. There is, therefore, no due process requirement that some of its income must be apportioned to those jurisdictions.

It is not inappropriate to note the complex administrative and compliance problems posed by ASARCO's position. Many multinational corporations receive dividend income from hundreds of subsidiary or affiliated corporations.[16] Under ASARCO's reasoning, proportionate property, payroll and sales information of each of these corporations must be determined to compute the apportionment factors in each state in which the dividend payee corporation files a state income tax return. In the case of foreign corporations in which the taxpayer is a minority shareholder, this information may not even be available to it.

In summary, there is no due process requirement that Idaho adjust the UDITPA factors to reflect the property, payroll and sales of dividend payor corporations. Although these corporations may not be engaged in a unitary business with ASARCO, the intangible assets generating the dividend income (i.e., the shares of stock) are acquired, managed and disposed of in the regular course of ASARCO's own unitary business, a part of which is con-

16 In 1974, 666 U. S. corporations with assets of at least $250 million controlled 11,346 foreign corporations having before tax earnings and profits. See IRS Publication 1026 "Supplemental Report, Statistics of Income—1974-1978, International Income and Taxes, U. S. Corporations and Their Controlled Foreign Corporations."

ducted in Idaho. Because the income is, therefore, part of ASARCO's unitary business income, that income may be apportioned among all of the states in which ASARCO conducts its business activities. The three factors of property, payroll and sales—without adjustment—accomplish that result. The Due Process Clause requires nothing more. Instead, to effect the factor adjustments proposed by ASARCO would accomplish anomalous and illogical results which are contrary to the unitary business principle and the requirements of the Due Process Clause.[17]

(B) Idaho's apportionment of ASARCO's income is not a violation of the "Foreign Commerce" Clause of the Federal Constitution.

In Part II (B) of its brief, ASARCO argues that Idaho is attempting to subject it to multiple taxation because its foreign source dividends and interest were actually subjected to foreign withholding taxes.

There are several difficulties with this argument. The most obvious is that the record is utterly devoid of any evidence establishing that such taxation actually oc-

17 Appellant's brief cites (at n. 24, p. 31) a recent article by MTC Executive Director Eugene Corrigan entirely out of context. The article says that states which do not fully apply the unitary business principle as part of their income tax law are failing to receive the share of income—and thus revenue—that is fairly due them. See, Corrigan "Mobilizing Interstate Taxation, *Tax Notes* Vol. XIII, No. 15, Oct. 12, 1981, p. 808. Apportioning dividends will, in some cases, result in more revenue than use of a combined report. In fact, in this case the Idaho Tax Commission had originally assessed ASARCO additional taxes based upon an apportionment of dividends from *all* companies in which ASARCO owned stock. This assessment was amended based upon the audit report's conclusion that six of the subsidiary corporations were engaged in a unitary business together with ASARCO and therefore should be included in a combined report. (J. A. p. 87a) This combination resulted in a *reduction* of taxes—just as the Corrigan article predicts that it should. (Rptr's Tr. pp. 222-226).

curred. ASARCO's argument is now more narrow than it originally presented to the Idaho court; it applies to foreign commerce only and not to interstate commerce. This narrowing of its argument does not change the correctness of the Idaho court's original ruling:

> The essence of ASARCO's argument under the commerce clause is that since Idaho's use of the UDITPA apportionment formula may result in duplicative taxation of its income by other states, the statute places an unconstitutional burden on interstate businesses. In particular, ASARCO emphasizes that since many states allocate income from intangible and tangible property to a single jurisdiction, the apportionment by Idaho of this same income will result in multiple taxation. However, *ASARCO has not established that it was in fact subject to multiple taxation* and the possibility of such multiple taxation has been rejected as a grounds for invalidating an apportionment statute. [Emphasis added] (J. S. App. p. 32a).

The factual record before this Court is unchanged. That record is devoid of any evidence showing multiple taxation on either an interstate or a foreign level. In fact ASARCO's foreign taxation argument first appeared in its first jurisdictional statement to this Court (in case number 78-1839) and appears to owe its origin to *Japan Lines Ltd. v. County of Los Angeles*, 441 U. S. 434 (1979), which was decided after the Idaho court's first decision. It is clear that the taxpayer must prove that the risk or actuality of foreign taxation exists. See *Northwestern States Portland Cement Company v. Minnesota*, 358 U. S. 450 (1959); *General Motors Corp. v. Washington*, 377 U. S. 436, 449 (1964); *Standard Pressed Steel Company v. Department of Revenue of Washington*, 419 U. S. 560, 563 (1975); *Moorman Mfg. Co. v. Bair*, 437 U. S. 267 (1978).[18]

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18 In its brief, ASARCO speaks only of the tax laws of Mexico and Australia. As we have noted, the record is utterly

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In any event, ASARCO's argument is without substantive merit. ASARCO, like Mobil, bases its argument on this Court's holding in *Japan Lines Ltd., supra.* However, *Mobil* clearly rejects each of the positions asserted by ASARCO. (See *Mobil, supra,* at 446-449). This Court rejected Mobil's same analogy to *Japan Lines* as "forced" for good reason. (*supra* at 448). The case can be easily distinguished. In *Japan Lines,* this Court determined that an ad valorem property tax imposed on foreign owned shipping containers violated the Foreign Commerce Clause primarily because the containers were instrumentalities of foreign commerce which had been taxed in Japan and were by treaty immune from "all duties and taxes whatsoever chargeable by reason of importation" (441 U. S. at 453). No such circumstance exists in this case. No treaty directly or indirectly limits or restricts the authority of a state to use the unitary business principle for appor-

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devoid of evidence showing foreign taxes were paid to any of these countries—or if they were paid, by which corporations or in what amount. The best we can do from the record is *assume* that, if any taxes were paid, ASARCO Mexicana paid taxes to Mexico and M. I. M. Holdings to Australia. This fails to account for three of the dividend payor corporations—Southern Peru, General Cable and Revere Copper. Additionally the withholding taxes in question may or may not apply to the interest or capital gains at issue (although a 10% tax on interest may apply in Mexico). The absence of an adequate factual record makes this issue speculative at best. Before attempting to rule on the effects of such foreign taxation, this Court should insist on a record which contains evidence establishing that the taxes were in fact paid, to which countries they were paid, by which corporations they were paid, the legal incidence of the taxes (e. g., do they apply to interest

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tioning income.[19] Nor, as this Court recognized in *Mobil*, has Congress clearly enunciated a federal policy in this area:

> Congress in the future may see fit to enact legislation requiring a uniform method for state taxation of foreign dividends. To date, however, it has not done so. (*Mobil, supra* at 449).

Idaho's tax in this regard is similar to Washington's business and occupation tax discussed in *Washington Rev. Dept. v. Stevedoring Assn.*, 435 U. S. 734 (1978):

> [T]he tax does not restrain the ability of the Federal Government to conduct foreign policy. As a general business tax that applies to virtually all businesses in the State, it has not created any special protective tariff. The assessments in this case are only upon business conducted entirely within Washington. No foreign business or vessel is taxed. Respondents, therefore, have demonstrated no impediment posed by the tax upon the regulation of foreign trade by the United States. (435 U. S. at 754).

Additionally, any such treaty or federal foreign policy, if it existed, would be irrelevant in this case. Treaties establish how foreign corporations are to be taxed by the United States or how U. S. taxpayers are to be taxed by a foreign power. ASARCO is a U. S. corporation (J. A. p.

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and capital gains?) and the amount of taxes that were actually paid.

19 The only effort to negotiate a treaty containing such a restriction was a provision, limiting state power to use the unitary business principle, inserted into the United States-United Kingdom Tax Treaty. The United States Senate refused to ratify the U. S.-U. K. treaty until those restrictions on state authority were removed. See Article 9 (4) of the Proposed Treaty, 124 Cong. Rec. 18402-18430, 18651-18670 and 19076-19078 (1978). This express refusal by the Senate to ratify a treaty which restricted states' authority to use the unitary method refutes ASARCO's position (see n. 25, p. 45 of its brief) that a contrary policy should be inferred from policies adopted for federal tax purposes.

54). At issue here is how a state of the United States is to tax the income of a U. S. taxpayer—not a question of international law or foreign policy at all. This Court recognized in *Mobil* that the Appellant's argument

> . . . attempts to focus attention on the effect of foreign taxation when the effect of domestic taxation is the only real issue. (*Mobil, supra* at 447).

Because the issue presented is a matter of domestic taxation only, there is no effect on the principal concerns expressed by this Court in *Japan Lines.* That is, there is no impairment of "federal uniformity in an area where federal uniformity is essential" nor is there a prevention of the federal government's ability to speak with "one voice" on the regulation of foreign commerce (*Japan Lines, supra,* 452).

ASARCO attempts to avoid the *Mobil* ruling by suggesting that it "now asserts the Foreign Commerce Clause argument which *Mobil* refrained from making—namely, that *any* 'local duplication of foreign taxes is prescribed' " (Appellant's Brief, p. 38).[20] However, because the issue is one of domestic—not international—taxation, ASARCO's restatement of the issue does not distinguish either *Mobil* or *Japan Lines.*

Finally, the tax policies established by the Internal Revenue Code evidence no intent by Congress to limit or restrict state taxes. The statutory scheme imposing income taxes at the national level and related treaties were never intended to limit a state's power to impose an apportioned net income tax on a multinational corporate en-

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20 In fact, the argument that ASARCO makes here was raised in *Mobil,* not by the taxpayer but by the amici curiae supporting the taxpayer's position. (See Brief of Committee on State Taxes of the Council of State Chambers of Commerce.)

terprise conducting substantial business activities within its borders. Under the federal tax laws, the entire net income of a domestic corporation, whether received from foreign or domestic "sources," is subject to federal income tax. For that reason, as a matter of policy, in order to avoid duplicative taxation at the *national* level of earnings derived from sources outside of the United States, the federal government allows a foreign tax credit (if elected in lieu of a deduction) for foreign income taxes paid directly by domestic corporations (I. R. C., § 901). The credit may not exceed the amount of the federal income tax imposed on the corporation's "foreign source income" as determined under §§ 862 and 863 of the Internal Revenue Code.

These provisions are relevant to avoid duplicative taxation of the entire worldwide income of a domestic corporation at the national level. They are irrelevant to an apportioned state net income tax, which by definition reaches only earnings fairly attributable to a corporation's activities within the borders of the taxing state. They were not intended to, and have never been interpreted as, precluding a properly apportioned net income tax at the state level.

The Internal Revenue Code provisions dealing with the classification of income from sources within or without the United States cover not only dividends but virtually all forms of income, including interest, rents, royalties, compensation for services, and sales income (see I. R. C., §§ 861-863). If the argument that the federal policies underlying the foreign tax credit require that "foreign source" dividends receive special state tax treatment were accepted, it is difficult to see why special rules

would not also be dictated for "foreign source" interest, royalties and sales income of a multinational taxpayer. The opinion in *Mobil* recognized this problem:

> Second, nothing about the logic of Mobil's position is limited to dividend income. The same contention could be advanced about any income arguably earned from foreign commerce. If appellant's argument were accepted, state taxing commissions would face substantial difficulties in attempting to determine what income does or does not have a foreign source. (*Mobil* at 447).

State income taxes have always been imposed in addition to the federal income tax, albeit at a fraction of the rate of that imposed by the federal government. States have never been required by statute or treaty to grant a credit for income taxes paid to either the United States or to any foreign country, so long as the corporation's net income was fairly apportioned to activities within the state. The fact that a credit for foreign income taxes may be allowed under federal law with respect to "foreign source income" is a matter relevant to federal, not state, income tax policy. A properly apportioned state net income tax imposed in addition to any national income taxes does not constitute duplicative *state* taxation of income arising from interstate and foreign commerce. It is duplicative taxation of income *among the states* that is the concern of the commerce clause, and such duplication is precluded by a rule of fair apportionment.

This Court recognized in *Mobil* that "Concurrent federal and state taxation of income, of course, is a well established norm." 445 U. S. at 448. There is no reason to prohibit concurrent taxation by states and foreign gov-

ernments, when it exists as an "established norm" in regard to state and federal taxes.[21]

CONCLUSION

For all of the foregoing reasons, this Court should affirm the decision of the Idaho Supreme Court without change.

DATED January 15, 1982.

Respectfully submitted,

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State of Idaho

21 Compared to the U. S. federal tax, the Australian and Mexican taxes are small; 15% in Australia, 10% in Mexico (Appellant's brief pp. 37-38). These foreign taxes are fully creditable against the federal income tax ASARCO pays in the United States. IRC §§ 901-905. This credit eliminates any impact the foreign tax may have on ASARCO. The only duplication of tax is between the federal and state tax—i. e., the "established norm" recognized and accepted by this Court in *Mobil, supra,* at 448. Additionally, the federal credit is an election. A taxpayer may elect to claim the foreign taxes either as a credit or a deduction. If the taxpayer elects the deduction it will obtain the same deduction on its Idaho state income tax return, because the income base under the Idaho Income Tax Act is federal taxable income. See *Idaho Code* § 63-3022.